AR88

06 Annual Report

titan logix corp.

Creating Instrumentation Solutions – Everyday

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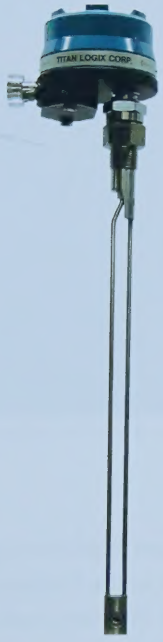
titan logix corp.

Our mission is to be the North American market share leader in mobile tank level measurement and control while maintaining our market interests in burner management and level gauging.

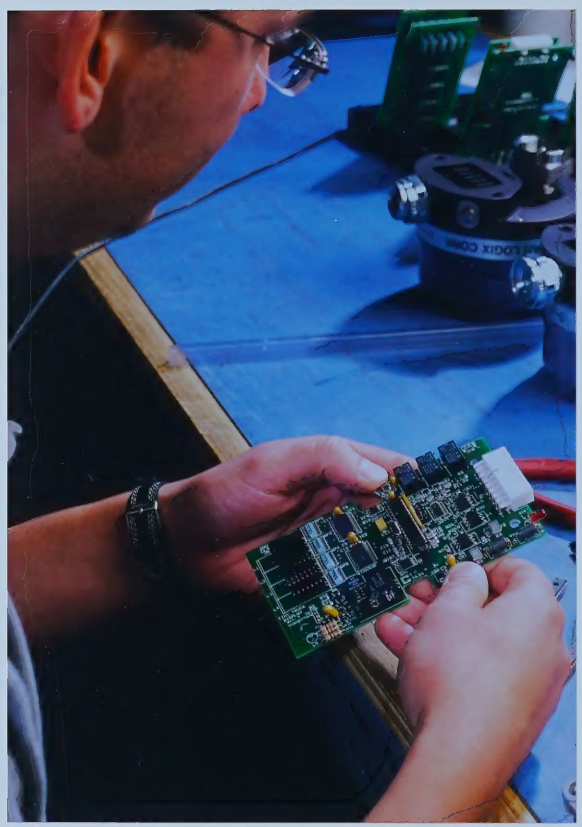


We design, manufacture, distribute, and support our products, which include the following:

- Guided wave radar liquid gauging and control systems for mobile tankers;
- Electronic burner control systems for atmospheric industrial heaters;
- Mechanical and electronic liquid level gauging systems for storage tanks and process vessels;
- Communication and control systems enabling remote telemetry management of site processes; and
- Mud level monitoring for oil and gas drilling well control.

LETTER To The Shareholders

We are pleased to report we reached a significant milestone in our objective of becoming the North American leader in mobile tank level measurement and control. Titan Logix Corp. reached sales of $7 million in fiscal 2006, exceeding its $6.3 million projection. This was achieved by focusing on our strategic plan to continue to differentiate ourselves as market leaders in our key technologies. This plan guides our decision-making, business planning and our thinking. Thanks to the commitment of our employees, customers, investors and suppliers we generated record net earnings and gained a significant increase in our North American market penetration.



Titan Logix Corp. reported net earnings of $440,882 for the year ended August 31, 2006 as compared to $339,635 for the previous year. Sales consistently increased over the past two fiscal years as the Company continued to focus on its flagship products, the FGI 301 burner management system and the TD80 TDR tank truck level gauge. This modest growth in earnings is due to investments being made to position the Company for accelerated future growth.

The foundation of the Company has been strengthened through a committed effort to improve the effectiveness and efficiencies of operational teams throughout the Company. Our manufacturing team improved internal production communication and established stronger communication between production and sales. Sales and marketing embarked upon an improved customer relationship management system to secure long term partnerships with both current and future customers. Our Lampman, Saskatchewan operations contributed revenues of $2.1 million, a 38% increase from fiscal 2005.

In keeping with our focus of continued enhancements to our product line, the FGI 351 burner management system (the modified and upgraded FGI 301) passed regulatory testing and is now available for sale. Orders for this new system have been very strong. During fiscal 2006, the Company commenced marketing and selling a new mechanical gauge innovation (patent pending) to the VISI brand that is giving the Company a significant competitive advantage in this sector of the industry.

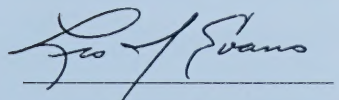
In May 2006 Titan entered into a sales and service distributor agreement with Garsite, a leading U.S. manufacturer of aircraft refuellers, to promote, sell and service Titan's TD80 radar liquid level gauging and overfill prevention system for mobile tankers. Garsite manufactures several models of aircraft refuellers in North America. Garsite refuellers are in service every day at nearly every major U.S. airport and in over 80 countries in 6 continents. Under the contract Garsite will promote, sell and service Titan's TD80 in the territories of the U.S., Central and South America as an exclusive representative within the aviation industry.

During fiscal 2006 a Short Form Offering was undertaken to position the Company for growth. Gross proceeds on the August 30, 2006 first closing of the Offering were $806,240. Additional gross proceeds of $361,200 were received in September 2006 for total financing of $1,167,440. The resulting strengthened working capital position enables the Company to accelerate the research and development and marketing required to support our objective of becoming the North American leader in mobile tank level measurement and control.

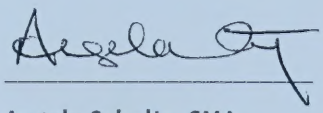
Fiscal 2006 was a positive year, creating a solid foundation for future success. The Titan board of directors and management team would like to thank our employees for their commitment and the shareholders for their patience and confidence as we continue to build a strong and vibrant high technology industrial instrumentation company.

Titan's management and staff are confident, committed, and enthusiastic about the Company's future.

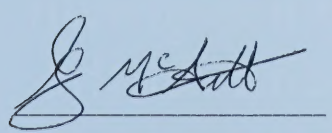
Respectfully submitted on behalf of the Board of Directors.



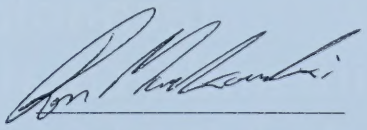
Les J. Evans
President and Chief Executive Officer



Angela Schultz, CMA
Vice-President Finance and Administration and Chief Financial Officer



Greg McGillis, PEng, EE
Vice-President Business and Product Development



Ron Markowski, MBA
Vice-President Sales and Marketing

MANAGE

Today however, the automation technology market has grown significantly, creating a demand for the products Titan Logix Corp. specializes in.

Discussion and Analysis

This discussion and analysis of operations as of November 3, 2006 should be read in conjunction with the Company's audited consolidated financial statements and related notes for the year ended August 31, 2006. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP).

The following discussion has been prepared by management and has been reviewed and approved by the Audit Committee and Board of Directors. Certain statements in this report constitute forward-looking statements. Such statements involve risks, uncertainties and other factors which may cause actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

OVERVIEW

The Company is a high technology industrial instrumentation and controls company focused on the design, manufacturing, distribution, and servicing of instrumentation and automation technologies, primarily for the oil and gas, chemical and transportation industries. For many years, these industries have operated with significant dependence on manual intervention. Today however, the automation technology market has grown significantly, creating a demand for the products the Company specializes in.

The Company designs, manufactures, distributes, and supports its products, which include the following:

- Guided wave radar liquid gauging and control systems for mobile tankers;
- Electronic burner control systems for atmospheric industrial heaters;
- Mechanical and electronic liquid level gauging systems for storage tanks and process vessels;
- Communication and control systems enabling remote telemetry management of site processes; and
- Mud level monitoring for oil and gas drilling well control.

The Company has an established operating infrastructure and a range of related products. The Company moved into the technology sector in the early 1990s by acquiring established and reputable companies. These include:

- Grimes Manufacturing Ltd. (formed in 1981), a manufacturer of level measurement and control products (acquired in 1988);
- Nagy Burner Control (formed in 1985), an industrial burner control specialist (acquired in 1998); and
- Sherrex Systems (formed in 1980), an industrial instrumentation and controls manufacturer (acquired in 2001).

These acquisitions have facilitated the Company's evolution as a manufacturing, sales and product support business, primarily serving the Western Canadian oil and gas, chemical and transportation industry.

PRODUCTS

The Company's products fall into five categories:

Transport Instruments

Mobile tankers (truck, trailer, rail car, marine and aircraft) often transport hazardous and/or expensive liquids. High-quality liquid level measurement and spill prevention systems are an essential component of the successful operation of such businesses, mitigating the occurrence of dangerous, expensive, and time-consuming spills, and helping to ensure more accurate inventory management of expensive liquids. Mechanical level gauges have traditionally been employed to safeguard against overflow, but they can be inaccurate and prone to failure.

The Company manufactures the TD80 liquid level measurement gauge specifically for the mobile tanker industry. The TD80 utilizes guided wave (or contact) radar technology, and has no moving parts. The Company believes that use of the TD80 liquid level control system on mobile tankers results in safer and more cost effective handling and transportation of hazardous and/or expensive liquids, and may also reduce clean-up and fluid loss costs.

Level and Flow Instruments

The Company or its predecessor have been developing liquid level measurement gauges and alarm systems for the energy sector since 1982, including the electro-mechanical gauging system known as the TPZ. The Company's level gauging technologies are designed to provide inventory-tracking capabilities as well as overfill protection with audible and/or visual alarms to alert operators of potential overfill conditions. They may also be set up to automatically shut down the loading procedure, helping to prevent overflow of stationary or transport tanks. The Company believes that its level measurement products help prevent spills and releases of oil and other toxic fluids, and may also assist to achieve cost savings and environmental protection.

Use of the TD80 liquid level control system on mobile tankers results in safer and more cost effective handling and transportation of hazardous and/or expensive liquids.

The VISI 1112 is designed to enable more accurate measurement of the level of non-hazardous liquids within tall stationary tanks, and reduces the incidence of gauge board malfunctions.

The Company manufactures a variety of level monitoring products for a range of industrial applications, including the TPZ 3310 AliGauger, an electromechanical, float-based level transmitter; the TD80 guided wave radar system; and the VISI range of mechanical gauge boards, including the recently introduced VISI 1112 (patent pending). The VISI 1112 is designed to enable more accurate measurement of the level of non-hazardous liquids within tall stationary tanks, and reduces the incidence of gauge board malfunctions.

The Company also manufactures devices for measuring liquid and gas flow rates and totals in hazardous areas, including totalizers, rate meters, pre-amps and converters. Products include the Flo Pro 9100, the SFT 881 turbine pre-amp with rate alarm and the SFT 835™ loop powered flow totalizer/rate meter. In addition, the Company distributes Ohmart/Vega free space radar and guided wave radar gauges for level measurement in stationary tanks, Primary Flow turbine flow meters and Ohmart/Vega vibronic level switches.

Remote Control and Communication Systems

The Company's remote control and communication systems are designed to enable remote telemetry of site processes; alarm reporting; logging of critical information for later analysis; and remote access to, and control of, off-site systems. The Company's capabilities include landline, radio frequency, and cellular communications. Products offered by the Company include the AP1000/2000 remote telemetry units (RTUs); Phoenix Contact spread spectrum radios; Barnett Engineering call-out systems and reporting units; and displays and controllers.

The Company has designed and manufactures field-mount display and control units that are approved for Class 1 Div 2 applications. The Company's 3500 Controller is designed to offer increased communication capabilities, reliability and ease of programming relative to earlier display and control systems manufactured by the Company. Marketing of the system commenced in the second quarter of the 2006 fiscal year.

Drilling Fluid Monitoring

Well control losses may negatively impact the environment, endanger worker safety, and result in economic losses, including insurance costs. The Company's Annulus Info Tracker™ ("AIT") 100 is designed for real-time detection of fluid gain or loss during oil and gas drilling operations. Recognition of such variances at an early stage of operations, and subsequent corrective action, may reduce the impact of well control losses that are detrimental to the environment and/or loss of circulation that causes well bore damage.

The Company is actively pursuing divestiture of the AIT 100.

Burner Controls

The Company manufactures burner control systems. Prior to June 2002, the burner control division of the Company operated under the name of Nagy Burner Control, a company that was acquired by Titan Logix Corp. in 1998.

The Company's FGI series Flame-Gard Ignition™ burner management systems are intended to meet a need for more precise and safe control of natural draft or atmospheric heaters in the harsh environmental conditions of remote oilfield sites. The Company believes that the FGI 351 is one of only a few products on the market offering complete certification for combustion safety control in this market sector. The FGI 351 is designed to automatically and safely ignite a heater's pilot and main burner flame, monitor this pilot flame, and to shut down gas flow in the event of pilot flame failure. The system may also re-ignite the flame. The Company believes that the FGI 351 may increase worksite safety, minimize heater downtime and reduce emissions of unburnt fuel gas.

The FGI 351 is the upgraded and enhanced version of the FGI 301, which has been sold since July 2004.

The FGI 351 is one of only a few products on the market offering complete certification for combustion safety control in this market sector.

STRATEGIC VISION *(Fig. 1)*

Our mission is to be the North American market share leader in mobile tank level measurement and control while maintaining our market interests in burner management and level gauging.

Our foundation is a company-wide commitment to building rewarding, long-term, ethical relationships with the four pillars of our company.

We recognize that employees, customers, suppliers and investors are key stakeholders in our mission in each target market we pursue. Our goal therefore will be to strengthen our relationship with each of these four key stakeholders by providing them with rewards that consistently meet or exceed their expectations.

Fig. 1

The Company endeavours to achieve this vision by continuously obtaining information about customers, competitors and markets; examining the information from a total business perspective; determining how to deliver superior customer value; and implementing actions that will lead to market share dominance and a resulting increased profitability.

PRINCIPAL MARKETS

The principal markets for the Company's products include the oil and gas, chemical and transportation industries. The Company's products are sold primarily in Western Canada and the Western United States.

DISTRIBUTION METHODS

The Company has an inside sales team as well as an outside sales team. The Company sells through dealers, distributors, fabricators, service companies, supply stores, resellers, original equipment manufacturers and engineering companies.

SELECTED ANNUAL INFORMATION *(Fig. 2)*

During fiscal 2006 the Company experienced moderate growth in sales and net earnings over the previous year as it continues to build the foundation for stronger sales and earnings in the future.

The Company has experienced a considerable turnaround in the past three years. Revenues have

Years ended August 31 (audited)	**2006**	**2005**	**2004**	**2003**
	$	$	$	$
Sales	7,048,960	5,584,826	5,390,247	4,413,152
Gross profit	2,779,152	2,248,974	2,140,804	1,544,505
Net earnings	440,882	339,635	223,502	(504,164)
Basic earnings per share	0.03	0.02	0.01	(0.03)
Diluted earnings per share	0.02	0.02	0.01	(0.03)
Total assets	4,327,231	2,900,178	2,512,018	3,200,686
Long-term liabilities	345,218	427,483	503,131	40,424
Dividends	nil	nil	nil	nil

Fig. 2

increased by 60% from 2003 and the Company reported earnings for fiscal 2006 of $440,882 as compared to a loss of $504,164 in fiscal 2003. During this period the Company has built a strong cash position with a balance of cash and cash equivalents at August 31, 2006 of $1,452,922 as compared to its bank indebtedness and bank loan balances of $228,379 and $1,088,000 respectively at August 31, 2003.

RESULTS OF OPERATION

Revenues and Net Earnings

Company net earnings increased to $440,882 in fiscal 2006 from $339,635 in fiscal 2005, an increase of $101,247. Income before other items for the year ended August 31, 2006 was $435,588 as compared to $375,724 for the previous year. The increase in profits of 30% is primarily attributed to the Company's strong sales of its flagship products.

Sales revenue for fiscal 2006 was $7,048,960 versus $5,584,826 for fiscal 2005. Sales were above target for the year reflecting an increase of 26% for the year ended August 31, 2006 as compared to the previous year. Sales growth of the TD80 TDR tank truck level gauge and transport instruments reflected an increase of 63% from the previous year. The Company's other level measurement products (including the TPZ and VISI) experienced an increase in sales of 37% in the year ended August 31, 2006 over the previous year. Sales in fiscal 2006 of the burner management and combustion products showed an increase of 17% from fiscal 2005.

As of this report date the Company is ahead of its budgeted sales and has committed sales to the end of the second quarter of fiscal 2007 for 35% of the projected budget. The Company's strategic initiatives for growth are being achieved as demonstrated through these advance sales.

The gross margin of $2,779,152 (39.4%) for fiscal 2006 maintained a level similar to the fiscal 2005 gross margin of $2,248,974 (40.3%).

General and Administration

General and administration expenses were $1,010,484 in fiscal 2006 compared to $843,886 in fiscal 2005. The increase of $166,598 for fiscal 2006, as compared to the corresponding period of 2005, was primarily a result of an increase in spending on initiatives undertaken to position the Company for growth. Approximately $85,000 of this amount is attributable to the decision to outsource and upgrade the Company's information technology system. Additional expenses of approximately $67,000 were incurred for increase in staffing and management remuneration to remain competitive within our industry. Additional increases related primarily to other staff development initiatives and the services of a management consulting firm specializing in corporate development and transactional advisory services.

Product Development

For the year ended August 31, 2006 product development expense was $251,160 compared to $170,819 for the previous year. The increased expenses were primarily due to the expansion of the Company's research and development department. This will increase the Company's competitive advantage as it makes plans to further develop its flagship products as part of its growth strategy. During the year the Company recorded an offset to product development costs of $16,258 compared to $67,873 for the previous year for contributions available under agreements with the National Research Council of Canada (NRC) under the Industrial Research Assistance Program (IRAP).

Marketing and Sales

Marketing and sales expense for fiscal 2006 was $975,784 compared to $755,159 in fiscal 2005. The increase is primarily due to an addition to the sales management team and increased expenditures incurred to penetrate selected North American markets. Planned increases in sales and marketing costs are a result of management's ongoing investment to increase revenues and market share.

SUMMARY OF QUARTERLY RESULTS *(Fig. 3)*

($000's, except per share amount)

Fiscal year	2006				2005			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Sales	1,943	1,725	1,718	1,663	1,554	1,411	1,386	1,234
Gross profit	786	629	697	667	686	536	547	480
Net earnings (loss)	205	(28)	117	147	142	76	115	7
Basic earnings per share	0.01	0.00	0.01	0.01	0.01	0.01	0.01	0.00
Diluted earnings per share	0.01	0.00	0.01	0.01	0.01	0.01	0.01	0.00

Fig. 3

The quarterly gross profits and net earnings have fluctuated during the year primarily as a result of the timing of the implementation of the Company's growth initiatives.

Fourth Quarter Results

The Company's net earnings in the fourth quarter of the 2006 fiscal year increased by $62,322 to $205,062 when compared to the same period last year. Sales revenue for the fourth quarter ended August 31, 2006 was $1,943,362 compared to $1,553,834 for the fourth quarter ended August 31, 2005. The increase in sales of 25% in comparison to the previous year's fourth quarter is consistent with the growth in sales reflected by the Company for fiscal 2006.

General and administration expenses for the three-month period ended August 31, 2006 were $281,973 compared to $226,646 for the comparable period of the previous fiscal year. This increase is primarily attributable to increased expenses in the quarter related to salaries and benefits and consulting services compared to the same period of the previous year.

Marketing and sales expenses for the fourth quarter of fiscal 2006 were $225,443 compared to $198,566 for the same quarter last year. The increase is due to increased sales bonuses recorded in the fourth quarter of fiscal 2006 as sales revenues exceeded target.

Liquidity and Capital Resources

On August 30, 2006, pursuant to a short form offering, the Company closed its first tranche raising gross proceeds of $806,240 through the sale of 2,519,500 units at $0.32 per unit. Each unit consisted of one common share and one half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share at a price of $0.40 until February 29, 2008. The Company also issued 242,350 warrants to the agents, each of which is exercisable to purchase one share at $0.40 until February 29, 2008. Share issue costs including stock based compensation on warrants of $195,270, totalled $369,278.

At August 31, 2006 the working capital increased by 75% to $2,969,735, from the August 31, 2005 year-end balance of $1,701,477, an increase of $1,268,258. Cash and cash equivalents as at August 31, 2006 were $1,452,922, an increase of $1,028,927 from the balance of $423,995 at August 31, 2005. The Company's strengthened cash and working capital position is a result of its increase in earnings, proceeds from warrants and options exercised, and the issuance of shares through its short form offering.

Accounts receivable increased by $305,442 to $1,308,167 from August 31, 2005. This increase directly relates to an increase in sales. Accounts payable and accrued liabilities increased by $215,831 to $812,040 from August 31, 2005. This is primarily a result of increased inventory requirements.

Inventories include raw material, finished goods, work-in-progress and resale items. Inventory at August 31, 2006 increased by $152,749 to $1,116,565 as compared to $963,816 at the 2005 fiscal year end. The increase is primarily a result of management's decision to have manufactured products more readily available for customer delivery.

Cash flow from operations during the year ended August 31, 2006 was $283,593 as compared to $412,755 for the previous fiscal year. Key factors in the decreased cash flow from operations include an increase in inventory and accounts receivable from August 31, 2005 balances. These contributing factors were offset by the increased accounts payable and increased profitability of the Company.

Cash flow from financing activities was $747,800 in fiscal 2006 compared to cash used in fiscal 2005 of $69,563. The increase was primarily due to net proceeds of $632,232 from the August 30, 2006 short form offering and $166,667 from exercising of warrants.

During fiscal 2006 the Company invested $108,007 in property, plant and equipment as compared to $32,921 in fiscal 2005. This increase is attributed to increased spending on equipment for rent, computer and licensing upgrades and leasehold improvements. Cash provided by investing activities included proceeds on the sale of investments in marketable securities of $103,683.

The Company has a credit facility of $600,000 with its chartered bank to fund operations as required. As a result of the financial performance for the year ended August 31, 2006 the credit facility was not used during fiscal 2006.

RELATED PARTY TRANSACTIONS *(Fig. 4)*

Certain directors provide services to the Company either directly or through companies, which they control. The amounts charged to the Company have been determined by negotiation between the parties and, in certain cases, are covered by signed agreements. Fees charged by such parties for the year ended August 31, 2006 were $102,762 (2005 - $123,474). The transactions are in the normal course of operations and are measured at fair market value.

At August 31, 2006 $2,989 of the $102,762 (2005 - $7,030) remained owing and is included in accounts payable.

In December 2005, 60,000 stock options to acquire common shares of the Company were granted to Directors. The options were granted as part of 2006 Board of Directors compensation.

OUTSTANDING SHARE DATA

The Company is authorized to issue 100,000,000 common shares with no par value. The common shares of the Company trade on the TSX Venture Exchange under the symbol "TLA". At August 31, 2006, the Company had 19,465,800 common shares issued and outstanding.

The Board of Directors may grant options to purchase up to 3,000,000 common shares. At the date of this report 1,310,000 stock options were outstanding that are potentially convertible to an equal number of common shares at an average exercise price of $0.14 per common share. There are warrants to acquire 1,502,100 common shares of the Company at $0.40 per share. In addition, 3,030,303 common shares would be issued if all convertible debenture holders exercised their conversion rights.

Name	Relationship	Purpose	2006	2005
Laurent Beaudin[1]	Director	Rent	$ 87,068	$ 103,519
		Royalties	725	1,223
		Debenture interest	872	1,049
		Note payable interest	1,302	1,261
James Besler	Director	Debenture interest	2,000	1,998
Sargent Berner	Director	Debenture interest	1,000	999
		Legal fees	5,457	8,943
Les J.Evans	Director	Royalties	764	1,223
		Debenture interest	1,000	999
		Note payable interest	1,574	1,261
Harvey Ramstead	Director	Debenture interest	1,000	999
Total			$ 102,762	$ 123,474

[1] Resigned as director effective June 19, 2006

Fig. 4

In addition to the 60,000 stock options granted to Directors during the year, 100,000 stock options were granted in October 2005 on appointment of the Company's Vice-President of Sales and Marketing and Vice-President of Business and Product Development.

DISCLOSURE CONTROLS AND PROCEDURES

As required by Multilateral Instrument 52-109, management carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of August 31, 2006. Based on that evaluation the Company's management, including the Chief Executive Officer and the Chief Financial Officer, have concluded that the disclosure controls are effective in providing reasonable assurance that all material information required to be filed has been made known to them in a timely fashion. The required information was effectively recorded, processed, summarized and reported and the disclosure controls and procedures are effective in ensuring that information required to be disclosed in the reports that the Company files is accumulated and communicated to management as appropriate to allow for timely decisions regarding required disclosure.

SUBSEQUENT EVENTS

On September 25, 2006, pursuant to the final closing of its short form offering, the Company issued 1,128,750 units at $0.32 per unit raising additional gross proceeds of $361,200. Each unit consisted of one common share and one half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share at a price of $0.40 until March 25, 2008. The Company also issued 76,100 warrants to the agents, each of which is exercisable to purchase one share at $0.40 until March 25, 2008. In addition, the Company issued 200,000 corporate finance units as a corporate finance fee. Each corporate finance unit consists of one common share and one half of one common share purchase warrant exercisable at a price of $0.35 until March 25, 2008.

OUTLOOK

Management is pleased with Titan's performance for the year ended August 31, 2006. The Company's continued sales achievements and increased cash position indicates that the strategic decisions that were made have set the Company on a path that will enable it to generate increased shareholder value.

Titan continues to retain the services of Erythana Ventures Corp., a management consulting firm specializing in corporate development and transactional advisory services. Erythana Ventures Corp. has knowledge and expertise with respect to facilitating the growth, value and financing of industrial and technology based ventures.

Titan's management is focused on continued growth for 2007. This growth will come primarily from three key strategic focuses: first, an increased market penetration of key Titan products in Western Canada; second, market development to expand existing Titan products into targeted North American geographical markets; and third, increasing sales through new product development. This will include enhancing the features of certain existing products and developing new products to satisfy the unmet needs of the mobile tanker and the oil and gas industries. Concurrently, the Company's growth strategy includes focusing greater effort on investor relations.

Financing obtained through the Company's short form offering will enable Titan to accelerate the product enhancements and new product development as part of its organic growth strategy.

Management will continue to explore new partnerships with reputable dealers and distributors to gain additional market coverage. Titan will consider the possibility of joint venture arrangements with companies that can provide increased effectiveness and efficiency to the Company's overall operations.

RISKS AND UNCERTAINTIES

Industry Factors

The Company is highly dependent upon exploration activity and new facility construction in the oil and gas industry. As this industry is prone to price fluctuation, Company's sales results may be impacted. Expansion into alternate industrial and commercial markets helps minimize the risk to the Company. Changes in world economic conditions may necessitate adjustments to account for reduced product sales. Global terrorism could potentially affect the oil industry, insurance, and other industries, which might in turn affect the Company.

Supply Shortages

The Company manufactures products utilizing certain components supplied by a number of major suppliers. As is customary in the industrial products distribution industry, the Company does not have long-term contracts with any of its major suppliers. Supply shortages can occur at times as a result of production difficulties, unanticipated demand or delivery delays and may have a short-term adverse material effect on the Company's results of operations and financial condition.

Key Employees

Future success of the Company largely depends on the continued efforts and performance of its executive team and key employees. Failure to attract and retain key employees with necessary skills could have an adverse material impact upon the Company's future business, operating results, and financial condition.

Competition

The market for the Company's products and services are expected to remain competitive. The Company's competition varies by product line, customer classification and

geographic market. Certain of the companies that compete with the Company have more established and larger sales and marketing organizations, larger technical staff and significantly greater financial resources than the Company.

Proprietary Protection

The Company relies on the protection of its technology, patents, confidentiality procedures and other measures to protect its proprietary information. The Company cannot determine whether future patent applications will be granted. The Company's efforts to protect its proprietary rights may not prevent unauthorized parties from attempting to copy aspects of its technology or to obtain and use information that the Company regards as proprietary.

Litigation may be necessary to enforce our intellectual property rights or defend against claims of infringement or invalidity. Intellectual property laws provide limited protection. The laws of some foreign countries do not protect proprietary rights as fully as do the laws of Canada.

Certain of the Company's intellectual property are licensed on a non-exclusive basis from third parties who may also license such intellectual property to others, including our competitors. If necessary or desirable, the Company may seek further licenses under the patents or other intellectual property of others. However, there are no assurances that such licenses will be obtained or that the terms of any offered licenses would be acceptable.

Product and Technology Enhancements

The Company's future growth depends on its ability to enhance its existing products; to develop new proprietary technology that addresses the varied needs of its prospective customers; and to respond to technological advances and emerging industry standards and practices in a timely and cost-effective manner. The development of technology involves significant technical and business risks.

Foreign Exchange

The Company may be subject from time to time to foreign exchange controls in countries outside of Canada, although no such claims are currently known to the Company.

ADDITIONAL INFORMATION

Additional information relating to Titan Logix Corp., including the Company's 2006 Annual Report, are available on SEDAR at www.sedar.com or on its website www.titanlogix.com.

FINANCIA

The Company's continued sales achievements and increased cash position indicates that the strategic decisions that were made have set the Company on a path that will enable it to generate increased shareholder value.

Management Discussion and Analysis Page 16

Statements

Grant Thornton LLP
Chartered Accountants
Management Consultants
Canadian Member of
Grant Thornton International

AUDITORS' REPORT

To the Shareholders of
Titan Logix Corp.

We have audited the consolidated balance sheets of Titan Logix Corp. as at August 31, 2006 and 2005 and the consolidated statements of earnings and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In our opinion these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at August 31, 2006 and 2005 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Grant Thornton LLP

Chartered Accountants
Edmonton, Canada
November 7, 2006

Consolidated Balance Sheets

As at August 31, 2006 and 2005

	2006	2005
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	1,452,922	423,995
Accounts receivable	1,308,167	1,002,725
Inventories (note 3)	1,116,565	963,816
Prepaid expenses	86,386	82,798
	3,964,040	2,473,334
Investments (note 4)	-	63,223
Property, plant and equipment (note 6)	260,606	245,135
Intangible assets (note 7)	102,585	118,486
	4,327,231	**2,900,178**
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	812,040	596,209
Note payable (note 9)	100,000	100,000
Current portion of long term debt (note 10)	82,265	75,648
	994,305	771,857
Long term debt (note 10)	345,218	427,483
	1,339,523	1,199,340
Shareholders' Equity		
Share capital (note 11)	3,102,772	2,458,455
Contributed surplus (note 11)	317,101	115,430
Deficit	(432,165)	(873,047)
	2,987,708	1,700,838
	4,327,231	**2,900,178**

Commitments (note 16)

See accompanying notes to consolidated financial statements.

On behalf of the Board

Director

Les. J Evans

Director

Harvey Ramstead

Consolidated Statements of Earnings and Deficit

For the years ended August 31, 2006 and 2005

	2006	2005
	$	$
Sales	7,048,960	5,584,826
Cost of sales	(4,269,808)	(3,335,852)
	2,779,152	2,248,974
Expenses		
General and administration	1,010,484	843,886
Product development costs (note 19)	251,160	170,819
Amortization of property, plant and equipment	90,235	87,485
Amortization of intangible assets	15,901	15,901
Marketing and sales	975,784	755,159
	2,343,564	1,873,250
	435,588	375,724
Other items		
(Loss) gain on disposal of property, plant and equipment	(443)	15,363
Gain on disposal of investments (note 4)	40,460	16,767
Write off of oil and gas related receivable (note 5)	-	(17,547)
Interest expense	(46,836)	(51,993)
Interest revenue	12,113	1,321
	5,294	(36,089)
Earnings for the year before income taxes	**440,882**	**339,635**
Income taxes (note 14)	-	-
Net earnings	**440,882**	**339,635**
Deficit, beginning of year	**(873,047)**	**(1,212,682)**
Deficit, end of year	**(432,165)**	**(873,047)**
Basic earnings per share (note 12)	**0.03**	**0.02**
Diluted earnings per share (note 12)	**0.02**	**0.02**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

For the years ended August 31, 2006 and 2005

	2006	2005
	$	$
Cash provided by (used in)		
Operating activities		
Net earnings	440,882	339,635
Items not affecting cash		
Amortization of property, plant and equipment	90,235	87,485
Amortization of intangible assets	15,901	15,901
Stock-based compensation	22,540	13,160
Loss (gain) on sale of property, plant, and equipment	443	(15,363)
Gain on disposal of investments	(40,460)	(16,767)
	529,541	424,051
Net change in non-cash working capital items (note 17)	(245,948)	(11,296)
	283,593	412,755
Financing activities		
Principal repayment of long term debt	(75,648)	(69,563)
Net proceeds from short form offering	632,232	-
Exercise of stock options	24,549	-
Exercise of warrants	166,667	-
	747,800	(69,563)
Investing activities		
Acquisition of property, plant and equipment	(108,007)	(32,921)
Proceeds from sale of property, plant and equipment	1,858	34,321
Proceeds from sale of investments	103,683	33,644
	(2,466)	35,044
Increase in cash and cash equivalents	1,028,927	378,236
Cash and cash equivalents, beginning of year	423,995	45,759
Cash and cash equivalents, end of year	**1,452,922**	**423,995**
Supplemental information		
Interest paid	42,375	48,698
Interest received	11,121	-
Non-cash financing activity:		
Warrants issued on short form offering [note 11 (d)]	195,270	-

See accompanying notes to consolidated financial statements.

1. NATURE OF OPERATIONS

The Company is a high technology industrial instrumentation and controls company.

Titan Logix Corp. ("Titan") designs, manufactures and services mechanical and electronic gauging for liquid measurement systems and electronic flame failure/ignition systems for atmospheric burners and has developed a patented method of detecting changes in the return flow of fluid in a well bore for use on drilling rigs. Titan also designs and manufactures a range of electronic monitoring and control equipment for the oil and gas, chemical and transportation industries.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Because the precise determination of many assets, liabilities, revenues and expenses are dependent on future events, the preparation of financial statements for a period necessarily includes the use of estimates and approximations, which have been made using careful judgment. Actual results could differ from those estimates. These financial statements have, in management's opinion, been properly prepared within the framework of the accounting policies summarized below.

a) Consolidation

These consolidated financial statements include the accounts of Titan Logix Corp. and its two wholly owned, inactive subsidiary companies, Alberta Industrial Technologies Ltd. (AIT) and MIR Gauges Inc.

b) Cash and cash equivalents

Cash and cash equivalents include cash on hand, balances with banks and investments in money market instruments with original maturities of one year or less.

c) Inventories

Inventories are valued at the lower of cost or net realizable value. Cost is determined on an average cost basis. The cost of work-in-progress and finished goods include an overhead and a labour component.

d) Investments

Marketable securities that are held for longer than one year are initially recorded at cost. Marketable securities are written down when there has been a loss in value other than a temporary decline.

e) Property, plant and equipment

Property, plant and equipment are carried at cost, less accumulated amortization. Long lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable from estimated future cash flows. Amortization has been calculated at the following annual rates:

Buildings	10% declining balance
Equipment	20% declining balance
Rental equipment	Straight-line over 4 years
Service vehicles	30% declining balance
Office equipment	Straight-line over 5 years
Leasehold improvements	Straight-line over the expected term of the lease

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

f) Intangible assets

Intangible assets are comprised of patents, website development and licenses. Patents and licenses are recorded at cost and amortized over their estimated useful lives using the straight-line method over a range of periods from 10 to 14 years. Website development is amortized over its estimated useful life of 5 years using the straight-line method.

Intangible assets subject to amortization are tested for recoverability whenever events or changes in circumstances indicate that its carrying value may not be recoverable. An impairment loss would be recognized when the carrying value of the asset is not recoverable and exceeds its fair value. As at August 31, 2006, there were no events or circumstances indicating that the carrying value of the intangible assets may not be recoverable.

g) Revenue recognition

Technology product sales are recognized at the time goods are delivered or services are provided and collection of proceeds from sale is reasonably assured. Service and rental revenues are recognized as services are rendered and equipment rented and there is reasonable certainty as to collectibility.

h) Income taxes

Future tax assets and liabilities are recognized for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Future tax assets are only recognized to the extent that the likelihood of realizing the asset is more likely than not. A valuation allowance is recognized to the extent the recoverability of future income tax assets is not considered more likely than not.

i) Foreign currency translation

Monetary items denominated in foreign currency are translated to Canadian dollars at the rate of exchange in effect on the balance sheet date. Non-monetary items are translated at the exchange rate in effect on the date in which the transaction occurred. Exchange gains and losses on translation are recognized in income in the year they arise. Foreign exchange losses of $22,389 (2005 -$3,511) from these transactions are included in sales.

Revenue and expense items are translated using the average exchange rate for the period.

j) Earnings per share

The computation of earnings per share has been calculated using the weighted average number of common shares outstanding during the year. The dilutive effect of convertible securities is calculated using the "if-converted" method. The dilutive effect of outstanding stock options and warrants is calculated using the "treasury stock" method.

k) Stock–based compensation

The Company recognizes, at the grant date, the compensation costs of stock options granted to employees and directors, measured at fair value and expensed over the option vesting period, with a corresponding increase to contributed surplus. Prior to September 1, 2004, under the intrinsic method, the Company disclosed the pro-forma effects to net earnings and earnings per share as if the fair value method had been used on stock-based awards to employees and directors and no compensation expense was recognized.

The Company has adopted a stock option plan for directors, officers, employees and consultants described in note 11. The fair value of option grants is determined using the Black-Scholes option pricing model.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

l) Product development costs

These costs are expensed in the period they are incurred unless they meet specific criteria related to technical, market and financial feasibility, in which case they are deferred and amortized over the expected useful life or written off if a product is abandoned. At August 31, 2006 and 2005, the Company had no deferred product development costs.

m) Government assistance

Government assistance related to research and development is recorded as a cost recovery when the expenditures are incurred, program conditions are met and reasonable assurance exists of collectibility.

3. INVENTORIES

	2006	2005
Raw materials	$ 581,833	$ 546,130
Work in progress and finished goods	534,732	417,686
	$ 1,116,565	$ 963,816

4. INVESTMENTS

	2006	2005
Marketable securities	$ -	$ 63,223

During 2006, the Company sold all of its investments in marketable securities for net proceeds of $103,683.

5. OIL AND GAS PROPERTY INTERESTS

During 2005, the Company wrote off receivables of $17,547 related to the sale of oil and gas properties in prior years.

6. PROPERTY, PLANT AND EQUIPMENT

2006	Cost	Accumulated Amortization	Net Book Value
Land	$ 10,000	$ -	$ 10,000
Building	56,381	39,792	16,589
Equipment	263,602	191,665	71,937
Rental equipment	328,045	270,918	57,127
Service vehicles	2,500	1,990	510
Office equipment	398,948	306,724	92,224
Leasehold improvements	34,657	22,438	12,219
	$ 1,094,133	$ 833,527	$ 260,606

6. PROPERTY, PLANT AND EQUIPMENT (cont'd)

2005	Cost	Accumulated Amortization	Net Book Value
Land	$ 10,000	$ -	$ 10,000
Building	56,381	37,949	18,432
Equipment	250,971	175,260	75,711
Rental equipment	290,066	236,693	53,373
Service vehicles	2,500	1,771	729
Office equipment	363,382	276,492	86,890
Leasehold improvements	21,081	21,081	-
	$ 994,381	$ 749,246	$ 245,135

7. INTANGIBLE ASSETS

2006	Cost	Accumulated Amortization	Net Book Value
Patent	$ 150,000	$ 71,610	$ 78,390
Website	29,381	26,935	2,446
Licenses	28,072	6,323	21,749
	$ 207,453	$ 104,868	$ 102,585

2005	Cost	Accumulated Amortization	Net Book Value
Patent	$ 150,000	$ 64,407	$ 85,593
Website	29,381	21,059	8,322
Licenses	28,072	3,501	24,571
	$ 207,453	$ 88,967	$ 118,486

Payments due under the license agreement are described in note 16.

8. BANK LOAN

The Company has a $600,000 (2005 - $500,000) bank line of credit that is due on demand for operating purposes, with interest at prime plus 1.0%. As of August 31, 2006 and 2005 $nil had been drawn on the bank line of credit. Accounts receivable, inventory and a general security agreement over all the assets of the Company have been pledged as collateral.

9. NOTE PAYABLE

The note payable bears interest at 4.5% per annum calculated semi-annually. The note, due October 31, 2006 was extended to January 31, 2007 subsequent to fiscal year. It is due based on the number of products manufactured by the Company using its AIT technology. If it is not repaid by the due date the note holders have the option to receive 2% of the outstanding shares of AIT for every $5,000 of outstanding note payable.

Of the $100,000 principal balance of the note payable, $33,333 is due to a director of the Company.

10. LONG TERM DEBT

	2006	2005
Agricultural Financial Services Corporation (AFSC) loan bearing interest at 8.75% per annum, repayable over 60 months commencing January 1, 2004 with blended monthly payments (principal and interest) of $8,191, secured by a mortgage on land and buildings located at Lampman Saskatchewan with a carrying value of $26,589, a general security agreement, and a priority agreement.	$ 227,483	$ 303,131
Debentures issued April 21, 2004 maturing April 21, 2009, bearing interest at 10% per annum payable quarterly in cash. The debentures are convertible to common shares at a rate of $0.06 in principal amount or interest in the first two years and the conversion price will increase by 10% in each subsequent year. Each debenture was issued with one warrant for each $0.06 in principal amount advanced by the subscriber. Two warrants entitled the holder to purchase one additional common share at $0.10. All warrants were exercised in April 2006.	200,000	200,000
	427,483	503,131
Less current portion	82,265	75,648
	$ 345,218	$ 427,483

The debt component of the debentures was determined by discounting the stream of future payments of interest and principal at the prevailing market rate for a similar liability without an associated equity component. The carrying amount of the equity component of the debentures was then determined by deducting the carrying amount of the financial liability from the amount of the debentures as a whole. Under this approach, it was determined that the full amount of the debentures relates to the debt component and no amount was assigned to the equity component.

10. LONG TERM DEBT (cont'd)

Of the $200,000 principal balance of the debentures, $50,000 was issued to directors of the Company. Interest on debentures in the amount of $5,872 (2005 - $6,044) was paid to directors during the year.

Scheduled debt repayments to maturity are as follows:

2007	$ 82,265
2008	89,461
2009	255,757

Interest expense on long-term debt was $42,104 (2005 - $48,211).

11. SHARE CAPITAL

Authorized

100,000,000 common shares without par value

Issued	2006		2005	
	Number of Shares	Amount	Number of Shares	Amount
Balance, beginning of year	15,069,633	$ 2,458,455	15,069,633	$ 2,458,455
Issued on exercise of warrants	1,666,667	166,667	-	-
Issued on exercise of options	210,000	40,688	-	-
Issued on short form offering	2,519,500	436,962	-	-
Balance, end of year	19,465,800	$ 3,102,772	15,069,633	$ 2,458,455

At August 31, 2006, there were 15,000 shares held in escrow with respect to an agreement issued in 1983. The Company has initiated the process for the release of these shares.

a) Share Offering

On August 30, 2006, pursuant to a short form offering, the Company closed its first tranche raising gross proceeds of $806,240 through the sale of 2,519,500 units at $0.32 per unit. Each unit consisted of one common share and one half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share at a price of $0.40 until February 29, 2008. The Company also issued 242,350 warrants to the agents, each of which is exercisable to purchase one share at $0.40 until February 29, 2008. Share issue costs including stock based compensation on warrants issued, totalled $369,278.

11. SHARE CAPITAL (cont'd)

b) Contributed Surplus

For stock options granted to employees and directors after September 1, 2004, the Company records compensation expense using the fair value method. Fair values are determined using the Black–Scholes option pricing model. Compensation costs are recognized over the vesting period as an increase to stock based compensation expense and contributed surplus. When options or warrants are exercised, the fair value amount in contributed surplus is credited to share capital. During the year, contributed surplus has changed as follows:

	2006	2005
Balance, beginning of year	$ 115,430	$ 102,270
Stock based compensation – options granted	22,540	13,160
Warrants issued on short form offering	195,270	-
Stock options exercised	(16,139)	-
Balance, end of year	$ 317,101	$ 115,430

c) Stock Options

The Company has a stock option plan for directors, officers, employees and consultants and permits the issue of options to purchase common shares of the company. Subject to approval by the Board of Directors and the TSX Venture Exchange, a maximum of 3,000,000 (2005 – 3,000,000) common shares are reserved for issue under this plan. The number of options and exercise price is set by the Board of Directors of the company at the time of issue, provided that the exercise price shall not be less than the market price of the common shares on the stock exchange on which such shares are traded. The options issued vest in accordance with vesting schedules determined at the time of grant and may be exercised for a period not longer than five years from the time of issue.

On October 18, 2005 the Company granted 100,000 options exercisable at $0.28. The compensation expense is recognized over the five year vesting period of the options. For the 20,000 options vested during the first quarter, the Company has recorded stock-based compensation expense of $10,380. The fair value of the options granted was $0.23 per option, estimated using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 3.8%, dividend yield of 0%, volatility factor of 109.9%, and an expected life of 5 years.

For the 60,000 options granted December 16, 2005, exercisable at $0.18 the Company has recorded stock-based compensation expense of $8,400. The fair value of the options granted was $0.14 per option, estimated using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 3.9%, dividend yield of 0%, volatility factor of 109%, and an expected life of 5 years.

The Company has recorded stock based compensation in the amount of $3,760 on options that vested during the year and were granted in previous years.

The weighted average fair value of stock options granted since the beginning of the year was $0.20.

11. SHARE CAPITAL (cont'd)

The following is a continuity of stock options outstanding:

	2006		2005	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
Outstanding, beginning of year	1,360,000	$ 0.13	1,250,000	$ 0.12
Granted	160,000	0.24	160,000	0.16
Exercised	(210,000)	0.12	(50,000)	0.10
Outstanding, end of year	1,310,000	$ 0.14	1,360,000	$ 0.13
Exercisable, end of year	1,170,000	$ 0.13	1,280,000	$ 0.12

Options outstanding and exercisable

Exercise price	Number outstanding and exercisable	Number outstanding but not exercisable	Weighted average remaining life in months
$0.08	40,000	-	29
0.10	100,000	-	10
0.11	100,000	-	31
0.12	570,000	-	17
0.14	50,000	-	40
0.15	200,000	-	12
0.18	90,000	60,000	46
0.28	20,000	80,000	50
	1,170,000	140,000	21

d) Warrants

On April 21, 2006, warrants issued with the April 2004 issuance of debenture, to purchase 1,666,667 shares, were exercised. Two warrants entitled the holder to purchase one additional share at a cost of $0.10 per share.

The Company has recorded share issue costs of $195,270 for the 1,502,100 warrants issued at $0.40 per unit with respect to the August 30, 2006 short form offering. The fair value of the warrants issued was $0.13 per warrant, estimated using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 3.06%, dividend yield of 0%, volatility factor of 108.9%, and an expected life of 1.25 years

11. SHARE CAPITAL (cont'd)

The following is a continuity of warrants outstanding:

	2006		2005	
	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
Outstanding, beginning of year	1,666,667	$ 0.10	1,666,667	$ 0.10
Short form offering [note 11(a)]	1,502,100	0.40	-	-
Exercise of warrants	(1,666,667)	0.10	-	-
Outstanding, end of year	1,502,100	$ 0.40	1,666,667	$ 0.10
Exercisable, end of year	1,502,100	$ 0.40	1,666,667	$ 0.10

12. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	2006	2005
Numerator for basic earnings per share (net income attributable to common shareholders)	$ 440,882	$ 339,635
Effect of dilutive securities		
Debentures converted to common shares	20,000	12,800
Numerator for diluted earnings per share	$ 460,882	$ 352,435
Denominator for basic earnings per share (weighted average number of common shares)	15,722,964	15,069,633
Effect of dilutive securities		
Debentures converted to common shares	3,181,818	3,333,333
Warrants converted to common shares	711,441	1,567,447
Stock options converted to common shares	667,356	350,167
	4,560,615	5,250,947
Denominator for diluted earnings per share (adjusted weighted average shares assumed conversions)	20,283,579	20,320,580
Basic earnings per share	$ 0.03	$ 0.02
Effect of dilutive securities	0.01	-
Diluted earnings per share	$ 0.02	$ 0.02

12. EARNINGS PER SHARE (cont'd)

The computation of the weighted average shares assumes that the outstanding options have been exercised at the earlier of the grant date or beginning of the year. Excluded from this calculation are nil (2005 – 20,000) exercisable options and 1,502,100 (2005 – nil) warrants because the exercise prices were greater than the average market price of the common shares.

13. RELATED PARTY TRANSACTIONS

Services are provided to the Company by directors of the Company or through companies which they control. The following transactions relate to such services and are in the normal course of operations and are measured at fair market value:

	2006	2005
Rent of a manufacturing facility to a company controlled by a director	$ 87,068	$ 103,519
Legal fees to a law firm at which a director was associate counsel	5,457	8,943
Debenture interest to directors (note 10)	5,872	6,044
Royalties to directors	1,489	2,447
Note payable interest to directors (note 9)	2,876	2,521
	$ 102,762	$ 123,474

At August 31, 2006 $2,989 (2005 - $7,030) remained owing and is included in accounts payable.

14. INCOME TAXES

a) Temporary differences

The Company's net future income tax balance is as follows:

	2006	2005
Future income tax assets		
Non-capital losses	$ 3,479,623	$ 3,545,332
Property, plant, and equipment	165,167	210,528
Intangible assets	(29,126)	(31,170)
Investments	43,163	16,188
Capital losses	4,055	3,090
Share issue costs	47,123	-
Valuation allowance	(3,710,005)	(3,743,968)
	$ -	$ -

14. INCOME TAXES (cont'd)

b) Income tax rate reconciliation

The Company's reported income tax rate on operating earnings differs from the statutory rate as follows:

	2006		2005	
	Amount	Percentage of Pre-Tax Income	Amount	Percentage of Pre-Tax Income
Income taxes calculated at the statutory rate	$ 149,679	33.95	$ 119,005	35.04
Income taxes adjusted for the effect of:				
Valuation allowance	(93,038)	(21.10)	(65,182)	(19.19)
Impact of rate change on opening temporary differences	(60,925)	(13.82)	(56,937)	(16.76)
Non-deductible expenses and other	4,284	0.97	6,783	2.00
Non-taxable portion of taxable gains	-	-	(3,669)	(1.09)
	$ -	-	$ -	-

c) Non-capital losses

The Company has non-capital losses of $10,077,101 available to reduce future taxable income, the tax effect of which has not been recorded in these financial statements. These losses expire as follows:

2010	$ 743,763
2014	9,333,338

15. FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and note payable approximate their fair values due to the short-term maturities of these instruments. The carrying amount of the Company's long term debt approximates its fair value. The Company's exposure to credit risk is as indicated by the carrying amount of its accounts receivable. The Company is subject to foreign currency risk in that it has both receivables and payables denominated in foreign currencies. It is management's opinion that the foreign currency risk is not significant. The Company does not use derivative instruments to reduce its exposure to foreign currency risk. The bank line of credit is subject to interest rate cash flow risk as the required cash flow to service such possible debt will fluctuate as a result of the changing prime interest rate.

16. COMMITMENTS

Revenues derived from AIT related products are subject to a 3% royalty. During the year, these royalties were $2,295 (2005 – $3,670), which has been included in the cost of sales.

Pursuant to a license agreement with the Lawrence Livermore National Laboratory revenues from the sale of TD80 products manufactured under the license are subject to a royalty of 5% with a minimum annual royalty fee of $25,000 US for the life of the license. The license remains in force for the life of the last-to-expire issued patent under the agreement which is May 2014. During the year, these royalties were $127,591 (2005 - $101,191) and were included in the cost of technology sales.

17. NET CHANGE IN NON-CASH WORKING CAPITAL ITEMS

	2006	2005
Accounts receivable	$ (305,442)	$ 3,250
Inventories	(152,749)	(127,665)
Prepaid expenses	(3,588)	8,191
Accounts payable and accrued liabilities	215,831	104,928
	$ (245,948)	$ (11,296)

18. OPERATING LEASES

The Company is committed to future lease payments for office space and manufacturing facilities and automotive and office equipment under the terms of lease agreements as follows:

2007	$ 191,809
2008	31,420
2009	8,020
2010 and 2011	10,613

19. GOVERNMENT ASSISTANCE

During 2004, the Company entered into an agreement with the National Research Council Canada (NRC) under the Industrial Research Assistance Program (IRAP). Maximum contributions available under the agreement total $80,600 and the agreement terminated December 15, 2005. In June 2006, the Company entered into a second agreement with NRC under IRAP. Maximum contributions available under the second agreement total $50,000 and the agreement terminates December 31, 2006.

19. GOVERNMENT ASSISTANCE (cont'd)

As at August 31, 2006, the Company had received contributions totalling $80,600. During the current year contributions of $16,258 (2005 - $67,873) were offset against product development costs and at August 31, 2006 $8,890 (2005 - $4,293) is included in accounts receivable.

A breach of the agreement is grounds for suspension or immediate termination of the assistance and will render the total amount of all contributions made by NRC to the Company pursuant to the agreement immediately due and payable. The following constitute breaches of the contribution agreement: misrepresentation or the submission of false information to the NRC; failure by the Company to disclose relevant information which may have a negative impact on the Company's financial position; or failure of the Company to satisfy any of the warranties, terms, conditions, requirements or obligations under the contribution agreement. Obligations of the Company include: acceptable performance of the work to the satisfaction of the NRC; maintaining of adequate environmental protection; obtaining of NRC approval before commencing any human or animal experimentation; and maintaining adequate records of the performance of the work.

20. COMPARATIVES

Certain prior period figures have been reclassified to conform to the current period's presentation.

21. SUBSEQUENT EVENTS

On September 25, 2006, pursuant to the final closing of a short form offering the Company issued 1,128,750 units at $0.32 per unit raising additional gross proceeds of $361,200. Each unit consisted of one common share and one half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share at a price of $0.40 until March 25, 2008. The Company also issued 76,100 warrants to the agents each of which is exercisable to purchase one share at $0.40 until March 25, 2008. In addition the Company issued 200,000 corporate finance units as a corporate finance fee. Each corporate finance unit consists of one common share and one half of one common share purchase warrant exercisable at a price of $0.35 until March 25, 2008. Estimated share issuance cost for this final closing are $57,000 excluding expenses for stock based awards.

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